No. 8425

In the United States
Circuit Court of Appeals
For the Ninth Circuit

In the Matter of
JAMES MARTIN KIRKPATRICK,
Debtor.

E. H. HARDT,
Appellant,

vs.

JAMES MARTIN KIRKPATRICK,
Appellee.

Appellant's Opening Brief

SURR & HELLYER
Citizens National Bank Building, San Bernardino
Solicitors for Appellant

Barnum & Flagg Company, San Bernardino, Calif.

INDEX

TABLE OF CASES

No. 8425

In the United States

Circuit Court of Appeals

For the Ninth Circuit

In the Matter of
JAMES MARTIN KIRKPATRICK,
Debtor.

E. H. HARDT,
Appellant,

vs.

JAMES MARTIN KIRKPATRICK,
Appellee.

Appellant's Opening Brief

A. STATEMENT OF THE CASE

This appeal arises from an order of the District Court of the United States for the Southern District of California, Central Division, declaring a certain sale of land under the terms of a deed of trust to be invalid (Tr. pages 29-35). This order, in opinion form, is reported in 17 Fed. Supp. at page 56 and following.

The order was made in proceedings under section 75-s of the Bankruptcy Act and was rendered pursuant to a "Petition For Injunction" filed by the appellee and debtor (Tr. pages 15-20), to which petition appellant had filed his verified "Answer to 'Petition For Injunction' " (Tr. pages 21-26).

No evidence was introduced in support of the allegations of the petition or answer (Tr. p. 27). Therefore, the facts as they are hereinafter stated are taken from the pleadings alone.

Obviously, since appellee was the moving party, seeking an injunction, the burden was on him to prove his case, and in all matters where the petition is denied by the answer, appellee has failed to prove his allegations, and the denials of the answer must be taken as true.

The facts, then, as they appear from the pleadings, are as follows:

(a) On February 16, 1928, James Martin Kirkpatrick and Mary Kirkpatrick (hereinafter called "Kirkpatricks") made a note and deed of trust upon certain real property and water stock, to E. H. Hardt and wife, Pioneer Title Insurance and Trust Company being trustee (Tr. pages 16, 23-24).

(b) E. H. Hardt succeeded to ownership of the note and deed of trust as his sole property on September 7, 1933 (Tr. page 23).

(c) On October 18, 1935, the appellee started a proceeding under section 75 of the Bankruptcy Act (Tr. page 15).

(d) On April 17, 1936, Hardt filed a petition for a

dismissal of said proceeding, and for leave to sell the property subject to his deed of trust (Tr. page 16).

(e) On April 23, 1936, the debtor obtained an order extending to July 1, 1936, the time for debtor to apply for approval of a composition or extension proposal (Tr. pages 15-16).

(f) On May 15, 1936, the petition for dismissal came on for hearing (Tr. pages 16-17).

(g) On the same date an extension agreement was proposed, which Hardt was willing to accept if, upon the making of the agreement, the proceeding should be dismissed. This the debtor would not accede to, and no agreement was made (Tr. pages 17 and 21).

(h) On June 10, 1936, debtor filed his petition under subsection "(s)" of said section 75, and was adjudicated a bankrupt (Tr. page 17).

(i) On September 26, 1936, the Conciliation Commissioner denied said petition to dismiss (Tr. page 18).

(j) On October 6, 1936, a petition to review said denial was filed by Hardt, and the review is still pending (Tr. page 18).

(k) On October 13, 1936, Hardt caused sale to be made under his deed of trust, and bought the property affected at trustee's sale for $5,250, which was at least $500 more than it was worth (Tr. pages 18 and 25).

(l) No order was ever made by any court restraining or enjoining or purporting to restrain said sale (Tr. page 22).

(m) The time of commencement of foreclosure proceedings under said deed of trust is not stated in the pleadings, and it must therefore be assumed as against the debtor seeking the injunction (which assumption actually accords with the facts) that proceedings for foreclosure were started before any bankruptcy proceedings were initiated.

This question alone is presented to this Court for decision:

> "Should a sale of the debtor's property, made under a deed of trust, after the debtor has been adjudicated a bankrupt by virtue of section 75, subdivision '(s)' of the Bankruptcy Act, be set aside when the following conditions exist:
>
> 1. No order was ever made restraining or enjoining such sale.
>
> 2. The property was sold for more than it was worth.
>
> 3. The proceedings leading up to the sale were regular, and the sale was conducted in proper fashion.
>
> 4. The deed of trust was executed several years before the debtor filed any petition.
>
> 5. Steps to sell under the deed of trust were taken before the initiation of any bankruptcy proceedings."

B. ERRORS OF THE LOWER COURT

The essential error of the District Court was in giving an affirmative, instead of a negative, answer to the question stated above, and in holding the sale invalid.

As set forth in the "Assignment of Errors" (Tr. pages 38-39), it was fallacious to rule that the previous consent of the Bankruptcy Court was necessary to the validity of a trustee's sale, pending bankruptcy, made under a deed of trust executed long prior to bankruptcy, where sale proceedings were commenced before bankruptcy started.

Likewise the opinion of the District Court was based almost entirely on the premise that the preliminaries to sale were started during bankruptcy, whereas there was neither pleading nor proof to that effect; and the fact was that the original proceeding under section 75 of the Bankruptcy Act was not begun until about two weeks before the date noticed for sale.

Correspondingly, if the sale was valid, as we believe it to be, the lower Court erred in enjoining appellant from taking possession of the realty involved.

C. THE SALE WAS VALID, EVEN THOUGH THE DEBTOR HAS BEEN ADJUDICATED BANKRUPT UNDER BANKRUPTCY ACT SECTION 75s.

I. *No Legislative Prohibition of Sale Exists.*

The only statutory provisions which might be claimed to expressly forbid a sale under a deed of trust during the time that the farmer trustor is proceeding under the Frazier-Lemke Act (Bankruptcy Act, section 75, subsection [s]) are subdivisions "(o)" and "(n)" of said section 75, and paragraph (2) of said subsection "(s)".

Section 75, subdivision "(o)" provides that sales of the debtor's property under a power of sale, and certain other actions, shall not be had:

> "after the filing of the petition under this section and *prior to the confirmation or other disposition of the composition or extension proposed by the court.*"

The "composition or extension proposal" referred to is the proposal contemplated in subdivisions "(a)" to "(r)" of section 75, which the debtor is required to offer his creditors during his conciliation proceedings under those subsections as a prerequisite to taking advantage of subsection "(s)" above mentioned.

The filing of a petition under subdivision "(s)" of section 75 makes the previous composition or extension negotiations and proposals dead issues, and adjudication of the debtor to be a bankrupt is without doubt a "disposition of the composition or extension proposal by the court," thus terminating the automatic stay of sales.

This is clearly shown by In re Thisler (Dist. Ct. Kans., Jan. 28, 1935—C. C. H. "New Matters," pages 1333-36) wherein the referee's report, approved by Judge Hopkins, after an excellent discussion, says (page 1334):

> "The filing of an amended petition is an abandonment by the farmer of the conciliation proceeding, and the order of adjudication and reference to the referee is a 'disposition' by the court of all matters pending in the conciliation proceedings."

Coming now to subsection "(n)" of section 75, it says that:

> "The filing of a petition or answer with the clerk of court, or leaving it with the conciliation commissioner for the purpose of forwarding same to the clerk of

> court, praying for relief under section 75 of this Act, as amended, shall immediately subject the farmer and all his property wherever located, for all purposes of this section, to the exclusive jurisdiction of the court," etc.

Assuming, without conceding, that subsection "(n)" applies to proceedings under subdivision "(s)" of that section, no different rule is laid down by subsection "(n)" than has for years been enunciated by the courts.

For a generation or so, at least, the courts have recognized and said regarding a voluntary petition in bankruptcy that "the filing of the petition is a caveat to all the world, and in effect an attachment and injunction" (Mueller v. Nugent, 184 U. S. 1, 46 L. Ed. 405; in re Genestri, 12 Fed. Rep. (2d) 457; and a myriad of other cases). So it is plain that subsection "(n)" adds nothing except for the provision that the filing of a conciliation proceeding, and possibly a 75 (s) proceeding has the same effect as filing a voluntary bankruptcy petition.

The jurisdiction of the Court, however, is not here doubted, but the question is whether a sale under a trust deed is valid if the court does not, in the exercise of its jurisdiction, forbid the sale.

Next, in order of consideration, is paragraph (2) of subsection "(s)". It provides for a three-year stay of proceedings upon certain conditions, saying that when the conditions have been complied with:

> "the court shall stay all judicial or official proceedings in any court or under the direction of any official, against the debtor or any of his property for a period of three years."

Among other conditions to the stay mentioned are the

appraisal of the debtor's property and the setting aside to him of his exemptions. These conditions were not met in our case so the stay of subsection "(s)", paragraph 2, has no application.

Moreover, the stay contemplated is a judicial stay, not an automatic one, and no judicial stay was ever granted (Tr. page 22—Statement of Facts, supra).

In re Thisler (supra—C. C. H. "New Matters", pages 1333-36), referring to paragraph 7 of the former subsection "(s)", which corresponded to the present subsection "(s)", paragraph "(2)", bears out the fact stated above that any stay specified in subsection "(s)" is judicial, and says:

> "Furthermore, it is provided in paragraph (7) that 'then the court . . . shall stay all proceedings for a period of five years'. The subsection does not state what these proceedings are. It may be argued that they refer to the same proceedings listed in subsection (o). Even if this construction is sound, *the stay mentioned in paragraph (7) is a judicial stay and not an automatic statutory stay such as is seemingly provided for in subsection (o).*"

It therefore appears that no legislative prohibition against sales under deeds of trust exists so far as proceedings under section 75 (s) of the Bankruptcy Act are concerned, and that, until a stay order or injunction issues, such proceedings are on a par with regular bankruptcy proceedings so far as sales of the debtor's property under powers of sale contained in deeds of trust are concerned.

II. *There Is No Distinction Between Sales Before Adjudication and Sales Thereafter.*

The title to a bankrupt's property "vests in the trustee

as of the date of filing the petition" (Heffron v. Western Loan and Building Co., June 1, 1936, 84 Fed. (2d) 301, at page 304). Therefore a sale under a deed of trust, which sale is made after the filing of the petition but before adjudication infringes as much upon the trustee's title and the Court's jurisdiction as does one after adjudication.

The Heffron case (supra) is so recent a decision of this Court, and contains such an excellent and thorough discussion upon the points which it covers, that reference to other authorities would simply be carrying coals to Newcastle. That opinion refers to the decision of Hiscock v. Varick Bank, 206 U. S. 28 (which established the rule that a private sale of encumbered property could be validly made after the intervention of bankruptcy, unless expressly restrained) and says, at page 304:

> "However, the opinion in Hiscock v. Varick Bank gives no indication that the holding was to be limited to a situation where the private foreclosure of a lien took place prior to the time when the trustee succeeded to the title of the bankrupt by relation back or otherwise."

From the language quoted it is plain that this Court is already firm in its opinion regarding the lack of distinction between sales before adjudication and after it.

III. *Sales Made During Bankruptcy Are Valid If Not Restrained.*

The opinion of the District Court from which this appeal is taken was based on a false premise.

It assumed that proceedings to foreclose the deed of trust by sale were commenced after bankruptcy intervened. We do not think that this should make any differ-

ence, even if it were the fact; but in truth, as we have shown in our statement of facts above, notice of default had long since been filed and notice of sale had been published before the appellee filed his petition under section 75 of the Act. Nowhere is there any contrary pleading or proof.

Making the incorrect assumption mentioned, the District Court ruled our sale was void, conceding, nevertheless, that:

> "It is true that the courts have recognized the right of the holder of a lien, who had begun proceedings for foreclosure prior to the institution of bankruptcy proceedings, and, *especially before adjudication* (Court's underscoring) to complete them. (See Hiscock v. Varick Bank (1907) 206, U. S. 28; Heffron v. Western Loan & Building Company (C. C. A. 9, 1936), 84 Fed. (2) 301.)"

Upon its own statement of the law the District Court's decision should be reversed.

But we need not content ourselves with the opinion mentioned. This very Circuit Court of Appeals, in the case of Heffron v. Western Loan and Building Company (84 Fed. (2d) 301, at 303), used the following language:

> "It is true, as the trustee contends, that, upon the filing of a petition in bankruptcy, all property in which the bankrupt has or may claim an interest passes under the control of the bankruptcy court and, upon adjudication, title to all property of the bankrupt vests in the trustee as of the day of the filing of the petition. Gross v. Irving Trust Co., 289 U. S. 342, 344, 53 S. Ct. 605, 77 L. Ed. 1243, 90 A. L. R. 1215; Isaacs v. Hobbs Tie & Timber Co., 282 U. S. 734, 737, 51 S. Ct. 270, 75 L. Ed. 645. The jurisdiction of the court

is not limited to the administration of property which belongs without question to the bankrupt; it extends to the determination of questions of title. Ex parte Baldwin, 291 U. S. 610, 616, 54 S. Ct. 551, 78 L. Ed. 1020.

While valid liens created more than four months prior to the filing of the petition are declared by section 67 of the Bankruptcy Act to be unaffected by bankruptcy proceedings, such liens nevertheless may be subjected to administration by the court and their validity and enforcement determined and carried out by the court. To this end the bankruptcy court may enjoin proceedings in other courts affecting the property, or may enjoin a mere nonjudicial satisfaction of a valid lien by private sale. Isaacs Tie & Timber Co., supra; Title & Trust Co. v. Wernich (C. C. A. 9), 68 F. (2d) 811, 812; Allebach v. Thomas (C. C. A. 4), 16 F. (2d) 853, 855, certiorari denied 274 U. S. 744, 47 S. Ct. 590, 71 L. Ed. 1325.

But is is equally well settled that, in the absence of factors requiring interference, a court of bankruptcy will not disturb the foreclosure of a lien by nonjudicial action when such foreclosure is in accord with the agreement of the lienor and lienee."

The United States Supreme Court put its seal of approval on this language by denying certiorari on November 16, 1936.

The following cases likewise are authority for the proposition that a sale may be made under a power of sale after bankruptcy has intervened, unless expressly proscribed by the court, viz:

Hiscock v. Varick Bank, 206 U. S. 28, 71 L. Ed. 945:

In re Genestri, 12 Fed. (2d) 456, 457;

In re North Star Ice & Coal Co., 252 Fed. 301, 303;

Ward v. First Nat. Bank of Ironton, Ohio, 202 Fed. 609, 612-13;

In re Southern Pharmaceutical Co., 286 Fed. 148, 151;

In re Smith, 3 Fed. (2d) 40, 42-43, affirmed 8 Fed. (2d) 1021.

The essence of all the above cited cases is found in the Heffron decision of this Court and is almost equally well expressed in the following statement:

> "I am aware of the cases which hold that 'the filing of the petition is a caveat to all the world, and in effect an attachment and an injunction.' Mueller v. Nugent, 184 U. S. 1, 22 S. Ct. 269, 46 L. Ed. 405. Consequently one cannot acquire an interest in property of the bankrupt adverse to the creditors after the filing of a petition. May v. Henderson, 268 U. S. 111, 45 S. Ct. 456, 69 L. Ed. 870. But in the case at bar the mortgagee acquired no new interest subsequent to the bankruptcy proceedings. His rights were fixed by his mortgage, given before the proceedings were instituted.
>
> The right of the mortgagee to enter pursuant to the statute is no more affected by the bankruptcy of the mortgagor than is his right to exercise his power of sale in the name of and as attorney for the bankrupt mortgagor. The trustee takes only subject to the rights of the mortgagee. Hall v. Bliss, 118 Mass. 554, 19 Am. Rep. 476. The fact that the mortgagee took no steps to obtain permission of the bankruptcy court before entering is therefore, in my opinion, immaterial. It was the bankrupt's equity of redemption in the mortgaged property, with the accompanying rights of possession until the mortgagee took possession, which was the property that was in custodia legis. I have no doubt about the power of the bank-

ruptcy court to take such steps as may be deemed necessary or expedient to preserve to creditors this equity of redemption and this right of possession, even to the extent of enjoining entry or sale under the power of the mortgage, but that power was not invoked or exerted in this case."

(In re Genestri, 12 Fed. Rep. 2d Series, 457.)

In view of the fact that the Heffron decision is only eight months old, and since in that opinion all of the above cited cases were considered, we deem it unnecessary and undesirable to here analyze them and quote them.

The District Court, however, cited and relied on five cases as holding that a sale without prior permission was void. They are:

Comer v. John Hancock Mut. L. Inc. Co., 80 F. (2d) 413;
In re Jersey Island Packing Co., 138 Fed. 625, at 627;
In re Eppstein, 156 Fed. 42;
Cohen v. Nixon and Wright, 236 Fed. 407; and
Allebach v. Thomas, 16 Fed. (2d) 853.

These cases were considered by this Court in making the Heffron decision, and there is no use reviewing them at length. Suffice it to say that if they did hold as the District Court interpreted them, they would be contrary to the Heffron opinion and overruled by it so far as this Ninth Circuit is concerned.

Summarizing, however, the language of the cases mentioned either is dictum or, the cases are distinguishable from ours upon the following grounds:

(a) *Comer v. John Hancock Mut. L. Ins. Co.* (supra)

—was a decision *upholding an order granting the right to sell* under a deed of trust. The validity of a prior sale was incidentally involved, but it had been positively enjoined, then an order permitting sale made, which latter order was vacated by stipulation of counsel, leaving the original restraining order in force. Any language concerning sales neither restrained nor permitted by order was obviously dictum.

(b) *In re Jersey Island Packing Co.* (supra)—Simply held that the bankruptcy court had jurisdiction to enjoin foreclosure if it wished to do so. This case made no mention of sales not forbidden.

(c) *In re Eppstein* (supra)—Set aside dismissal for lack of jurisdiction of summary proceeding to cancel tax deed executed after bankruptcy intervened. In this proceeding the trustee did equity by tendering the full amount due, *which the debtor here has not done.*

(d) *Cohen v. Nixon and Wright* (supra)—Said a sale without permission was bad, *but* ordered immediate resale by the trustee and *confirmed the original sale under a deed of trust in the event that the bankrupt trustee's sale did not realize the amount bid at the original trust deed sale.*

(e) *Allebach v. Thomas* (supra)—Simply held that a sale might be enjoined by the Court, and sustained an injunction based upon conflicting evidence as to the value of the property involved.

We need hardly urge that the cases just analyzed and the District Court's opinion, should not be permitted to override the mature ideas of this Honorable Court ex-

pressed in Heffron v. Western Loan & Building Co. (supra).

IV. *Denial of Appellant's "Petition to Dismiss and for Leave to Sell" Was Immaterial.*

While the debtor was still involved in his conciliation proceeding (Bankruptcy Act, section 75 ("a" to "r"), and before he took advantage of the Frazier-Lemke Act (Bankruptcy Act, section 75 (s)), appellant filed a petition to dismiss the proceeding and for leave to sell the property (Tr. page 16). Five months later, and after the debtor had been adjudicated a bankrupt under section 75 (s) this petition was denied (Tr. page 18). A petition to review the order of denial was filed and is still pending (Tr. page 18).

It may be that appellee will seek to make something out of the denial of the "Petition to Dismiss and for Leave to Sell." Therefore we shall consider it.

Of course, when the petition to dismiss was filed, subsection "(o)" of section 75 expressly forbade any sale without prior permission of the court. Necessity for such permission, however, expired, as we have shown above, when the debtor filed his petition under subsection "(s)".

The petition to dismiss related to the date of its filing, and no doubt the order of denial did likewise.

However, the order of denial did not purport to enjoin any sale (Tr. page 18), and left matters as if no consent had been asked or denied. The order was simply negative in character.

This being so, and the necessity for obtaining the Court's consent to sale having terminated, appellant properly and legally proceeded to purchase the property involved at a trustee's sale.

V. *The Sale Was Fair and Beneficial to the Bankrupt Estate.*

Appellant recognizes that if the sale had been attended with circumstances of fraud, or had been for an inadequate consideration, the Bankruptcy Court might have set it aside on that ground. (Heffron v. Western Loan and Building Co., supra.)

But the facts in this case are that the property sold for at least $500 more than it was worth, and the sale was in all respects regular.

The debtor's "Petition for Injunction" contained no allegation at all about the value of the property at the time it was sold (Tr. pages 15-20), but merely stated that the sale price was $5,250. Clearly this did not establish an inadequacy of price. Appellant's answer to the petition alleged that appellant bought the property for $5,250, but that when sold the market value of the realty and water stock purchased "did not exceed the sum of $4,750, and the amount bid and paid for said real propery and water stock (to-wit, $5,250) was and ever since has been far in excess of the value of said real property and water stock, and said sale was in all respects fair and regular" (Tr. page 25).

No other pleadings or evidence indicated any inadequacy of sale price.

This being so, there can be no basis for the District Court's order avoiding the sale, except the sole and erroneous one that precedent permission from the Court was essential to the sale's validity.

CONCLUSION

Simplicity is the key-note of this appeal. There is no evidence to sift—the questions involved are few.

In chief, the appellant's contention is that after a debtor has taken advantage of the Frazier-Lemke Act as amended, his secured creditor may conduct a sale under a valid deed of trust unless restrained by the Court.

If this Circuit Court of Appeals is to remain true to its own decision of eight months ago (Heffron v. Western Loan and Building Company, 84 Fed. (2d) 301) a reversal in this proceeding "must follow as the night the day."

Appellant is content to rest upon that opinion and the cases referred to in this brief.

Respectfully submitted,

SURR & HELLYER,

Solicitors for Appellant.